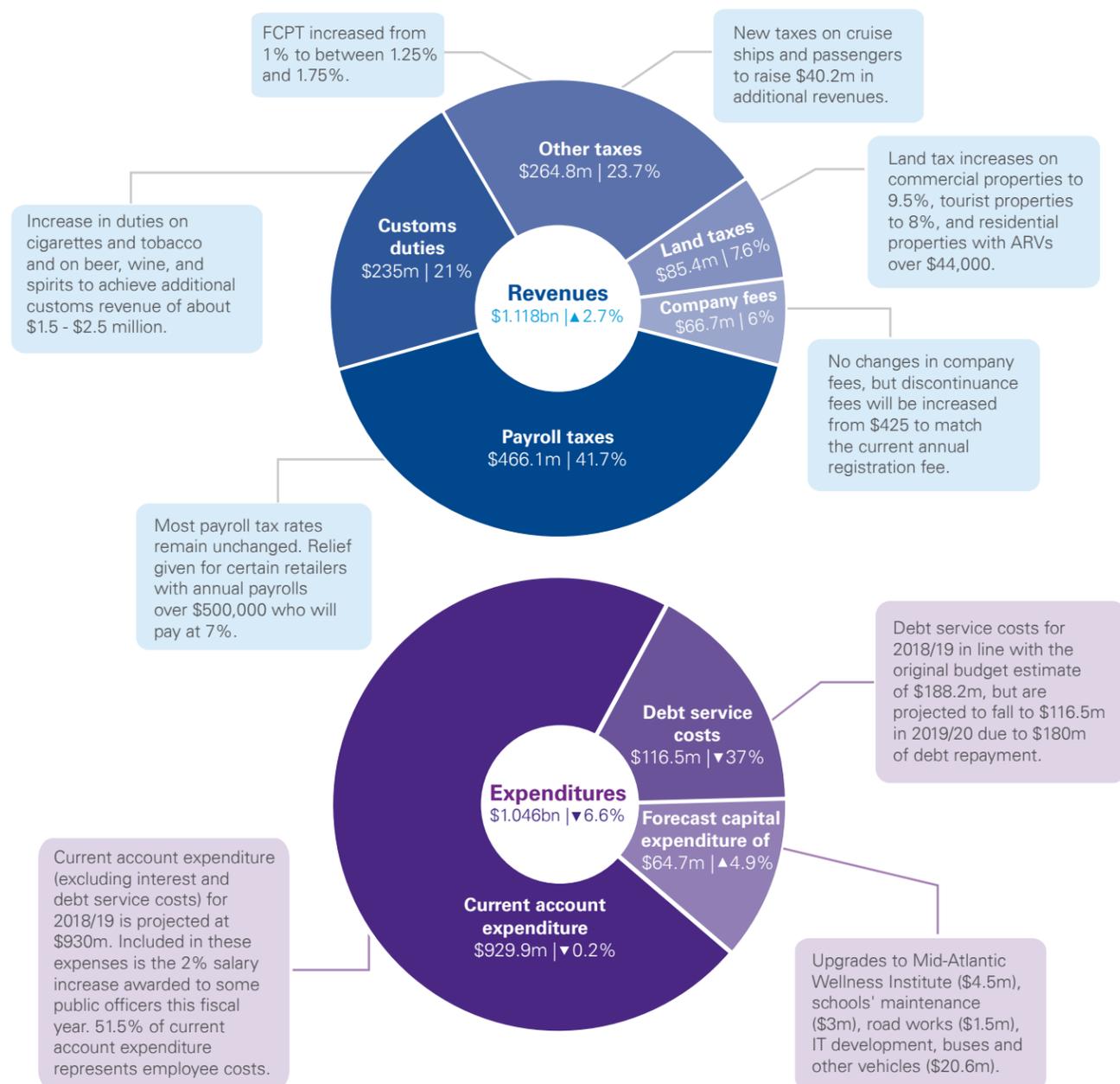
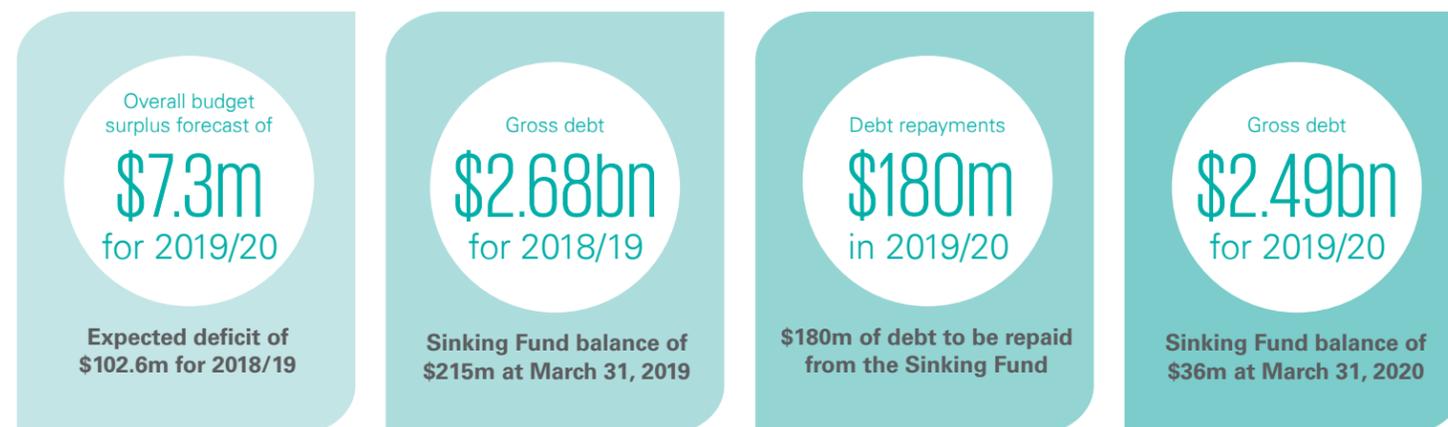


KPMG 2019/20 Bermuda Budget Snapshot

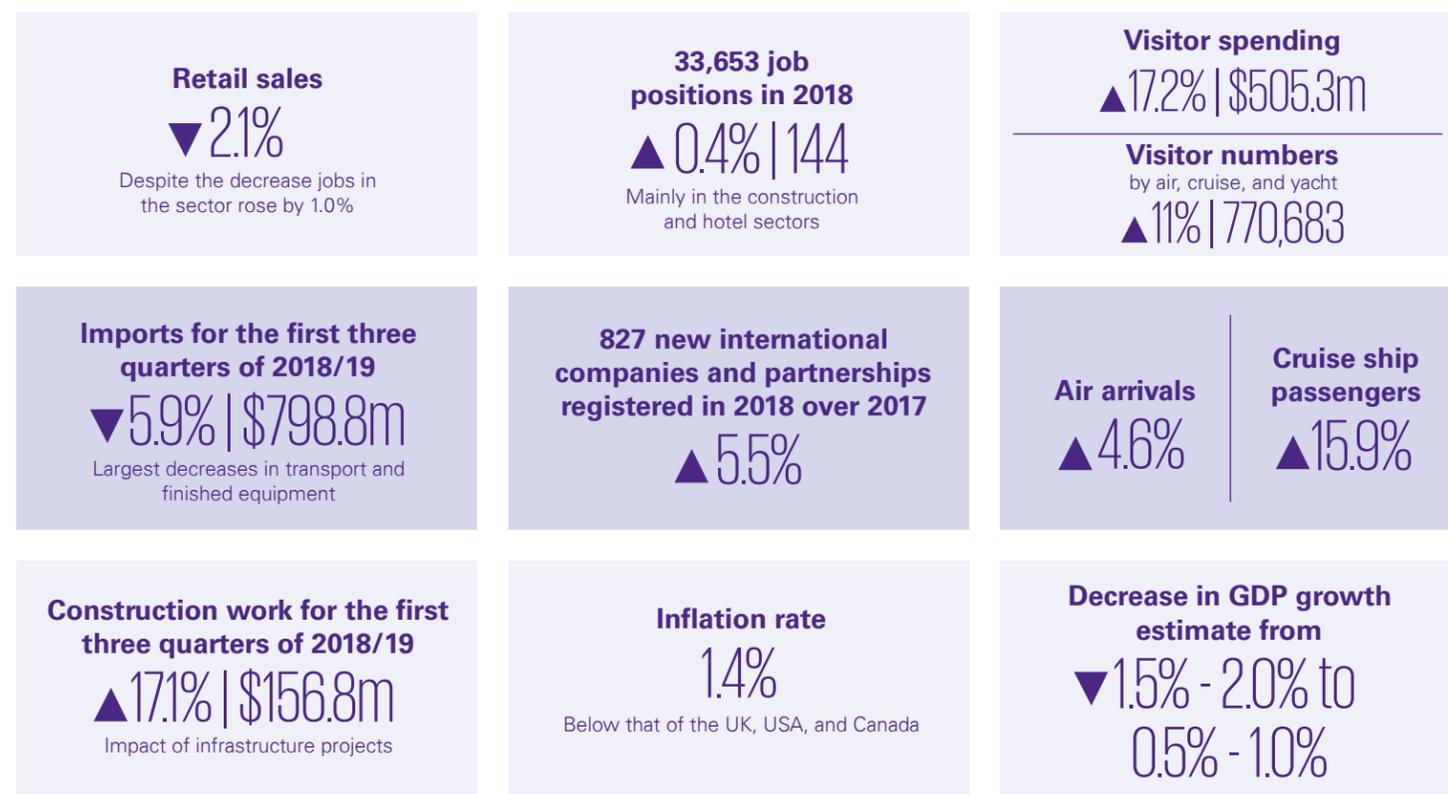
In his maiden budget statement, Minister of Finance, the Honourable Curtis Dickinson JP, MP, has delivered a budget surplus and Bermuda's debt is projected to fall next year for the first time since 2003. The Government plans to suspend the annual mandatory Sinking Fund payment and use the Fund to repay \$180 million of debt during 2019. The Minister has resisted the implementation of wider tax reforms at this time, given the uncertainty posed by the EU's Economic Substance legislation. The Government's focus continues to be on growing the economy, job creation, and reducing the National debt.



National debt at a glance



Bermuda's economy in 2018/19 at a glance



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New incentives and schemes

- New Economic Substance Incentive Programme (ESIP) will provide a two-year employer payroll tax concession for additional jobs created in Bermuda.
- The ESIP will also include the application of the existing New Business Work Permit Policy.
- The Government will pilot a mortgage guarantee programme where it will guarantee private bank mortgages in return for a reduction in interest rates charged to Bermudians for their mortgages.
- Creation of a Government-backed mortgage lender to relieve pressure on public sector employees by providing them with reduced mortgage rates. Taxes on mortgage refinancing will be eliminated.
- The Government will relax foreign ownership restrictions to create a demand for condominiums in the North East Hamilton Empowerment Zone.
- The Government will publish guidelines for the granting of exemptions from the 60:40 rule, while simplifying the application process.
- The Government is committed to advancing the National Health Plan and will shortly unveil economic reform to reduce the cost of health insurance and provide better coverage for Bermudians.
- The Government is in its final stages of producing the Integrated Resource Plan for Bermuda's future electricity needs.
- The Government will launch the Public Service Reform initiative to transform Bermuda's public services.

KPMG Opinion

The Government has proposed new incentives for home owners, which it hopes will lower mortgage rates and give Bermudians more disposable income to invest in the economy. It also aims to stimulate investment in the real estate sector by relaxing ownership restrictions for certain condominiums. We believe that further changes to the 60:40 rule will be needed to provide the direct foreign investment required to kickstart development projects of this nature.

The new ESIP is a positive step toward encouraging international companies to create jobs in Bermuda. The Government must continue to do more, including setting up physical locations on the island to offer existing and new international businesses a turnkey solution for employee relocation, reforming our immigration policies and reducing the overall cost of doing business in Bermuda. We must react quickly in order for Bermuda to be considered ahead of competing jurisdictions.



Revenues and expenditures

Revenues

- Forecasted total revenue is \$1.079bn in 2018/19. Estimated revenue is \$1.118bn for 2019/2020; an increase of \$39m or 3.61%.
- In response to stakeholder feedback during the Pre-Budget consultation, the Government concluded that it is not prudent to raise an additional \$50m in revenue at this time given the challenges faced by the economy and uncertainty over Economic Substance.

Expenditures

- Total expenditure is \$1.046bn for 2019/2020 – a decrease of \$73m or 6.6% from the 2018/19 revised estimate of \$1.120bn.
- Operating expenses (excluding interest and debt service costs) for 2018/19 are projected at \$932m or \$2.8m (0.3%) higher than budgeted. Included in total operating expenses is the 2% salary increase awarded to some public officers.
- Operating expenditures are forecast at \$929.9m for 2019/20; a marginal reduction of 0.2%.
- Capital expenditures for 2019/20 is set at \$64.7 million which is an increase of \$3m or 4.9% over the forecast spend for 2018/19 of \$61.7m.
- Debt service costs for 2018/19 will be in line with the original budget estimate of \$188.2m, but are projected to fall to \$116.5m in 2019/20 due to suspended Sinking Fund contributions.
- The Government expects to report a budget surplus of \$7.3m for 2019/20.

KPMG Opinion

While increasing revenues and removing the Sinking Fund contribution will balance the Budget and should see Bermuda's debt start to reduce over the coming years, there is a lot more to be done in reforming public services. The Government has taken steps to recognise this by establishing the Efficiency Committee to review the functioning of all Government departments and recommend improvements in the efficiency of operations. However, further structural changes to the public sector are required in order produce meaningful expenditure savings.



Other taxes and duties

- Increase of the Financial Service Tax on local insurance premiums by 1% and increase of the tax on banks' gross assets from 0.005% to 0.0075%.
- The Foreign Currency Purchase Tax (FCPT) will increase from 1.0% to between 1.25% and 1.75%.
- The sugar tax will be uprated from 50% to 75% on an extended group of items.
- The one-year land tax increases on commercial properties of 5% announced in the 2018 Budget will be reversed. However, land taxes are to increase from 7% to 9.5% on commercial properties and 7% to 8% on tourist properties.
- Land tax to increase for residential properties with an ARV greater than \$44,000, and decrease for ARVs less than \$22,000 under a new rate structure.
- Increase of stamp duty on all residential and commercial leases, and elimination of stamp duty on any mortgage refinancing for amounts up to \$750,000.
- A new tax structure for cruise ships and cruise ship passengers: a passenger departure tax, a cruise passenger visitor fee, and a large ship infrastructure tax (with the cabin passenger tax being repealed).
- Extension of temporary zero rate customs duty relief for hotels and restaurants by a further 5-year period on imported capital goods intended for renovation and refurbishment.

KPMG Opinion

The Pre-Budget Report signaled that the Government was considering levying a number of new taxes including on managed services provided by non-Bermudian businesses to local and international companies, a tax on dividends and on rental income. It is refreshing to see the Government took a collaborative approach and listened to stakeholders' feedback. Broadening the tax base to reduce the economy's reliance on payroll taxes and import duties is critical, but equally important is that new forms of taxation are considered and developed in concert with key industry stakeholders.

The Government should remain cautious of the impact that new taxes could and have on the cost of doing business in Bermuda and on the fragile economy. A move toward taxes based on consumption may result in a fairer and more efficient collection system, but will need to be balanced with a reform of the current levels of customs duties.



National debt

- Gross public debt will stand at \$2.68bn at March 31, 2019. The estimated gross public debt will decrease to \$2.49bn by March 31, 2020.
- The Government will suspend the mandatory 2.5% annual contributions to the Sinking Fund (\$64m in 2018/19). \$180m of the Sinking Fund will be used to repay Government notes as they mature in May and November of 2019. This is expected to reduce annual interest costs by \$12.1m.
- The Sinking Fund balance is projected to be approximately \$214.6 million at the end of 2018/19 and will fall to \$35.6m by the end of 2019/20.
- Sinking Fund contributions are expected to resume from future budget surpluses.

KPMG Opinion

We are encouraged that the Government remains committed to fiscal sustainability as a central priority and is taking the necessary steps to prudently manage debt through strategic refinancing to extended maturities and take advantage of favourable interest rates. Repayments from the Sinking Fund will help to lower interest costs next year, and allow Bermuda to present an overall budget surplus for the first time in some years.

As a result of the uncertainty facing Bermuda's economy from both domestic and global challenges, specifically in relation to the Economic Substance Act, the Government should continue to engage in wide consultation with Bermuda's stakeholder groups to ensure that the tax system meets both the country's fiscal needs while ensuring that Bermuda remains an attractive and sustainable jurisdiction of choice for international business. Wider reform is needed as incremental adjustments to the existing regime are unlikely to be sufficient for Bermuda's long-term standing.



Payroll taxes

- It was decided to leave most rates unchanged due to uncertainties in other revenue projections and as a result of Economic Substance requirements.
- The yield from payroll tax is estimated at \$466.1m in 2019/20, 41.7% of total Government revenues.
- Targeted payroll tax relief to certain retail businesses selling fashion, shoes, jewellery, and perfume with annual payroll greater than \$500,000 who will pay employer's payroll tax at a reduced rate of 7%.
- Removal of employer payroll tax for businesses that hire local musicians or entertainers for three years to encourage more businesses to hire local entertainers, and encourage more Bermudians to become involved in this industry.
- Mandatory e-filing for all businesses with gross annual payrolls in excess of \$500,000, and a recharge fee for businesses paying by credit card.

KPMG Opinion

The Government has recognised the need to move away from payroll tax as its primary method of raising tax revenues and continues to look at other ways of broadening Bermuda's tax base based on the Tax Reform Commission's recommendations. However, with the existing payroll tax mechanism already in place, this continues to be the Government's main source of revenue pending further tax reform. In an attempt to create efficiencies and reduce the time and resources of manually processing filed tax returns, the implementation of a new e-filing system is a welcome step in the right direction, as is the recharge fee for credit card payments.

“ The Minister of Finance delivered a fiscally balanced and practical approach in his first Budget statement. It is encouraging to see signs that Bermuda's economy is moving in the right direction. The Government's focus continues to be on growing the economy, creating jobs, and ultimately reducing the net National debt while also promoting public sector reform to create operational efficiencies within the sector. The suspension of the annual mandatory Sinking Fund contribution should provide the Government with the breathing space to execute on its economic growth strategy. The Budget is reflective of the challenging times we operate in and due consideration has been provided for the uncertainty resulting from the EU's Economic Substance requirements. ”



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